November 2017

Centum 1H18 Earnings Update

"Down but not out"

With 1H18 proving to be a challenging operating environment attributed to the drought and heightened political temperatures, Centum posted a 20.7% y/y slump in net earnings to KES 1.6B. This was driven by a 119.5% y/y plunge in operating profit from financial services (Sidian Bank)

Bloomberg Ticker :	**CENTUM KN**
Reuters Ticker:	**ICDC.NR**

Share Statistics

Current Price (KES)	43.00
Issued shares (M)	665.4
Market cap (USD M)	276.9
Year end	31 March
Free float (%)	44.7
Av daily trading vol (USD)	81,287

Price Trend

Source: Bloomberg

Breakdown of the firm's financials

- The firm's top-line edged up 1.3% y/y to KES 8.6B, with the gains recorded in trading revenue and investment income being almost written off by the slump in income from financial services. Sales from trading business encompassing publishing revenue and beverage sales leaped 15.8% y/y to KES 4.8B. Investment income and other income rose 15.4% y/y driven largely by unrealized gains on revaluation of KES 2.1B.
  Income from financial services plummeted 34.5% y/y attributed largely to the rate cap that wiped off 37.3% y/y of interest income earned largely by Sidian Bank
- Centum's costs outpaced the growth in the top-line surging 12.6% y/y to KES 6.4B. Operating costs in trading business rose 16.7% y/y to KES 4.2B. The rally in operating costs being faster than the segment's top-line resulted in a 70bps y/y decline in trading business operating profit margin to 11.5%. Increased investment in the pipeline of projects saw operating and administrative costs gallop 109.7% y/y to KES 525M.
  The financial services segment, mainly Sidian bank, has been employing a raft of cost-cutting measures which have in turn tamed operating costs. Sidian Bank has also been lowering interest earning deposit accounts which have kept finance costs in check. As a result of the aforementioned, funding and other costs incurred in the financial services sector dropped 8.3% y/y to KES 1.7B. Notwithstanding the drop in costs, the operating income from the segment resulted in a loss of KES 111M from a profit of 571M in 1H17. It is worth noting that the loss is 70.7% h/h lower in comparison to 2H17 loss, suggesting that strategies employed by the bank continue bearing fruit.
- Finance costs surged 57.2% y/y to KES 557M in line with the 16.1% y/y increase in borrowings to KES 22.4B. With the borrowings outgrowing the 7.1% increase in equity, net debt to equity rose 350bps y/y to 44.3%.
- Profit from associate companies furthered the strong growth trajectory, posting a 64.4% y/y leap to KES 568M. This was underpinned by the stellar performance of Nairobi Bottlers, Platcorp and Two Rivers Mall.
- The significant increase in profit from associate companies was not sufficient to counter the effects of the loss in financial services sector as well as jumps in operating and finance costs. This culminated in a 21.5% y/y drop in PBT to KES 2.2B. A 70bps y/y ease in the effective tax rate saw the group's PAT close 20.7% y/y lower at KES 1.6B.
- Lower profitability saw cash from operating activities slump 38.1% y/y The challenging operating environment in 1H18 saw the group cut-back on investing activities with cash used in investing activities easing up 73.3% y/y to KES 2.6B. During the period, Centum redeemed the KES 4.2B corporate bond that matured in September 2017. In addition, the group retired a KES 3.0B loan facility from RMB which was set to mature in

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December 2017 and subsequently obtained a KES 5.0B loan facility from RMB which matures over a 4-year period. The resultant effect of these transactions is a KES 2.3B cash outflow from financing activities. This resulted to a KES 264M increase in cash and cash equivalents for the year leaving cash and cash equivalents for the year largely unchanged.

Going forward

- With Almasi beverages recording a 10.0% y/y growth in sales volume, we project a continuation of the same which translates to additional growth for Centum's top-line. In addition, we anticipate operational efficiency to remain enhanced as a result of the significant investments in PET and RGB lines which are anticipated to buoy the bottom-line.
- Longhorn Kenya has planned to dispose its shareholding in LawAfrica Publishing as well as entering into a sale and lease-back agreement on its head-office. Disposing off its shareholding is a review of strategy aimed at growing the publisher organically rather than through acquisition with the latter proving rather expensive. The sale and lease-back is anticipated to release capital held in the head-office which will also be used to grow the publisher organically. The two exits are anticipated to realise gains on disposal to Centum given the conservative valuation policies employed by the group.
- Given the rate cap environment, Sidian bank is rethinking its business model opting to focus on non-funded income in line with market practice. In addition, the group has implemented cost cutting measures which are anticipated to protect the bottom-line in the long-run.
- In real estate, negotiations are at an advanced stage to bring onboard investors at development level in Pearl Marina and Vipingo. At Two Rivers, TRDL is planning on selling 32,650m^2 which is expected to be completed by FY18.

  Centum plans on raising the occupancy of the mall from 72.0% of Gross Lettable Area (GLA) to 85% by the end of the year translating to additional revenue for the mall. In turn, this would further increase the profit from associates augmenting the group's bottom-line.

  Two Rivers apartment project is already up and running with a targeted launch in 4Q18. Comprising of 196 units and a growing list of awaiting buyers, the sale of the units is anticipated to result to additional gains on disposal given Two Rivers Development Limited is a subsidiary of Centum.
- Despite calls for the cancellation of the Amu Power coal plant in Lamu, the consortium as well as Akiira geothermal plants were awarded letters of support from the Government of Kenya. The two plants are awaiting financial close with development commencing soon after.
- The group no longer wishes to progress with the 14,000 acres industrial agricultural project in Masindi, Uganda given the caveats on the land which made the investment unfeasible. Notwithstanding this, the vision for a large industrial project still stands with the investment anticipated to yield returns upon commencement.
- Centum's first school is projected to be opened in September 2018 which will not only diversify the group's top-line but also augment it.
- The group is at advanced stages of significant exits of some of its investments, in addition to the ones aforementioned. The delay in some of the exits has been attributed to investor jitters surrounding the political environment in Kenya. Seeing that these issues almost stand resolved, the group anticipates these exits to be concluded by FY18. Given the conservative valuation policies employed by the group, we anticipate huge gains on disposal supporting the group's bottom-line and may soften the blows suffered in 1H18.
- A bulk of the proceeds from disposal is anticipated to be directed to the marketable securities segment which could point to resumed investor confidence in the market from FY18. Given that we expect a rebound in the capital markets next year, we project additional income to Centum from this segment from next year onwards.

Bearing in mind that we have been on a bearish run for the better part of two years now, Centum's share price has been trading at a significant discount to book value. During the bullish run that ended towards the end of 2014, Centum's share price had corrected this deviation and we anticipate a return of the same in the medium-term. On the fundamental side, the counter remains sound with the pipeline of projects anticipated to yield returns to the company as well as its shareholders.

Centum is currently trading at KES 43.00 with P/B at 0.6x and P/E at 4.1x.

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1H18 Financials

Income statement KES M	1H17	2H17	1H18	h/h (%)	y/y (%)
Trading business					
Sales	**4,122**	**5,280**	**4,772**	**-9.6**	**15.8**
Operating costs	(3,620)	(4,585)	(4,223)	-7.9	16.7
Trading profit	**502**	**695**	**549**	**-21.0**	**9.4**
Financial services					
Income from financial services	**2,422**	**1,653**	**1,586**	**-4.0**	**-34.5**
Funding and other costs	(1,851)	(2,034)	(1,697)	-16.5	-8.3
Operating profit from financial services	**571**	**(381)**	**(111)**	**-70.7**	**-119.5**
Investment operations					
Investment and other income	**1,933**	**5,413**	**2,231**	**-58.8**	**15.4**
Realized gains on disposal of investments	13	1,020	11	-98.9	-11.8
Operating and administrative costs	(250)	(872)	(525)	-39.8	109.7
Finance costs	(355)	(694)	(557)	-19.7	57.2
Share of associate profits	**346**	**1,001**	**568**	**-43.2**	**64.4**
PBT	**2,760**	**6,183**	**2,167**	**-65.0**	**-21.5**
PAT	2,058	6,252	1,631	-73.9	-20.7
EPS (KES)	**2.57**	**8.36**	**2.07**	**-75.2**	**-19.5**

Statement of financial position	1H17	2H17	1H18	h/h (%)	y/y (%)
Portfolio investments	62,802	65,464	68,275	4.3	8.7
Cash and cash equivalents	5,384	5,639	4,921	-12.7	-8.6
Other assets	17,697	17,282	18,713	8.3	5.7
Total assets	**85,883**	**88,385**	**91,909**	**4.0**	**7.0**
Customer deposits	10,940	9,799	11,125	13.5	1.7
Borrowings	19,327	20,986	22,441	6.9	16.1
Other liabilities	8,351	8,127	7,739	-4.8	-7.3
Total liabilities	**38,618**	**38,912**	**41,305**	**6.1**	**7.0**
Total equity	47,265	49,473	50,604	2.3	7.1
Total equity and liabilities	**85,883**	**88,385**	**91,909**	**4.0**	**7.0**

Statement of cash flows	1H17	2H17	1H18	h/h (%)	y/y (%)
Net cash from operations	868	351	537	53.0	-38.1
Net cash from investing activities	(9,679)	5,603	(2,584)	-146.1	-73.3
Net cash from financing activities	3,528	(5,229)	2,311	-144.2	-34.5
Net changes in cash and cash equivalents	**(5,283)**	**725**	**264**	**-63.6**	**-105.0**
Opening cash and cash equivalents	10,197	4,914	4,657	-5.2	-54.3
Closing cash and cash equivalents	**4,914**	**5,639**	**4,921**	**-12.7**	**0.1**

Ratios and margins	1H17	2H17	1H18	h/h (%)	y/y (%)
Trading business profit margin (%)	12.2	13.2	11.5	-1.7	-0.7
Financial services profit margin (%)	23.6	(23.1)	(7.0)	16.0	-30.6
Group net profit margin (%)	24.2	46.8	19.0	-27.8	-5.3
ROaE (%)	10.0	12.9	3.3	-9.7	-6.8
Total debt to equity	40.9	42.4	44.3	1.9	3.5
Net debt to equity	30.5	31.0	34.6	3.6	4.1
NAV per share (KES)	59.08	67.33	69.74	3.6	18.0
P/B (x)			0.6		
P/E (x)			**4.1**		

Source: Centum, ApexAfrica Estimates

Appendix

Investment ratings

✦ **Buy:** A total return is anticipated in excess of the market's long-term historic annual rate (approximately 10%). Total return expectations should be higher for stocks that possess greater risk.

✦ **Hold:** Hold the shares with neither a materially positive total return nor a materially negative total return anticipated.

✦ **Sell:** Stock should be sold as materially negative total return is anticipated.

Disclaimer

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